NIXON SHOCK

The Nixon Shock marked a pivotal moment by ending the Bretton Woods System, a key event that reshaped the global economy and should inspire appreciation for its historical importance. It describes a set of significant economic policies announced by Richard Nixon on August 15, 1971. These actions halted the convertibility of the dollar into gold, and changed the international monetary system.

The Nixon Shock occurred in 1971, when the US dollar was devalued, and a fixed exchange rate system was established, pegging the US dollar to gold at $35 per ounce. Other currencies were pegged to the US dollar, and the US guaranteed that foreign central banks could convert dollars into gold. This Bretton Woods system was under stress, including:

- US Balance of Payments Deficit (Vietnam War and Welfare Spending)
- The surplus of U.S. dollars kept outside the country is known as the "Eurodollar glut."
- Gold drain occurred as nations demanded conversion.
- The Triffin Dilemma involves providing global liquidity, which can undermine confidence in the dollar.

What was the Nixon shock?

On August 15, 1971, Nixon announced three primary measures.

(a) **Closing the Gold Window**
   - Suspension of dollar-to-gold convertibility
   - The gold standard has been discontinued in practice.
   - The dollar shifted into a fiat currency.

(b) **10% Important Surcharge**
   - Temporary tariff on imports
   - Seek to pressure other nations to revalue their currencies.

(c) **Wage and Price Controls**
   - Implementing a 90-day freeze to address inflation.
   - Extensive intervention in a capitalist economy.

Immediate Global Impact

- Collapse of Bretton Woods
  - It includes the fixed exchange rate system that collapsed in 1973.

  - The world transitioned to floating exchange rates.
- Smithsonian Agreement (Dec 1971)
  - The dollar has depreciated by approximately 8%.
  - The gold price increased to $38 per ounce.
  - The system failed within one year.

Long-term Consequences

The long-term effects of the Nixon Shock include the adoption of floating exchange rates, increased central bank independence, and the dollar's rise as the dominant reserve currency, despite no longer being backed by gold. The Rise of Dollar Hegemony (Paradox) describes how, despite no longer being backed by gold, the US dollar has grown in strength as the world's primary reserve currency. It also points out that an increasing portion of oil trade is conducted in dollars, creating the Petrodollar system.

Inflation and stagflation in the 1970s were driven by these factors, with oil shocks exacerbating the situation. Financial globalization involves the growing volume of currency trading, the expansion of derivatives markets, and the growth of speculative capital flows.

Impact on Developing Countries (Including India)

- Increased fluctuations in exchange rates
- Increase the balance during payment crises.
- Reliance on funding from the IMF and World Bank
- Resulted in subsequent structural adjustment programs.

Significant Points Covered

- The end of the Keynesian era of monetary stability.
- Shift towards neoliberal global finance
- Classical depiction of the Triffin Dilemma and Hegemonic Stability Theory.
- The decline of embedded liberalism

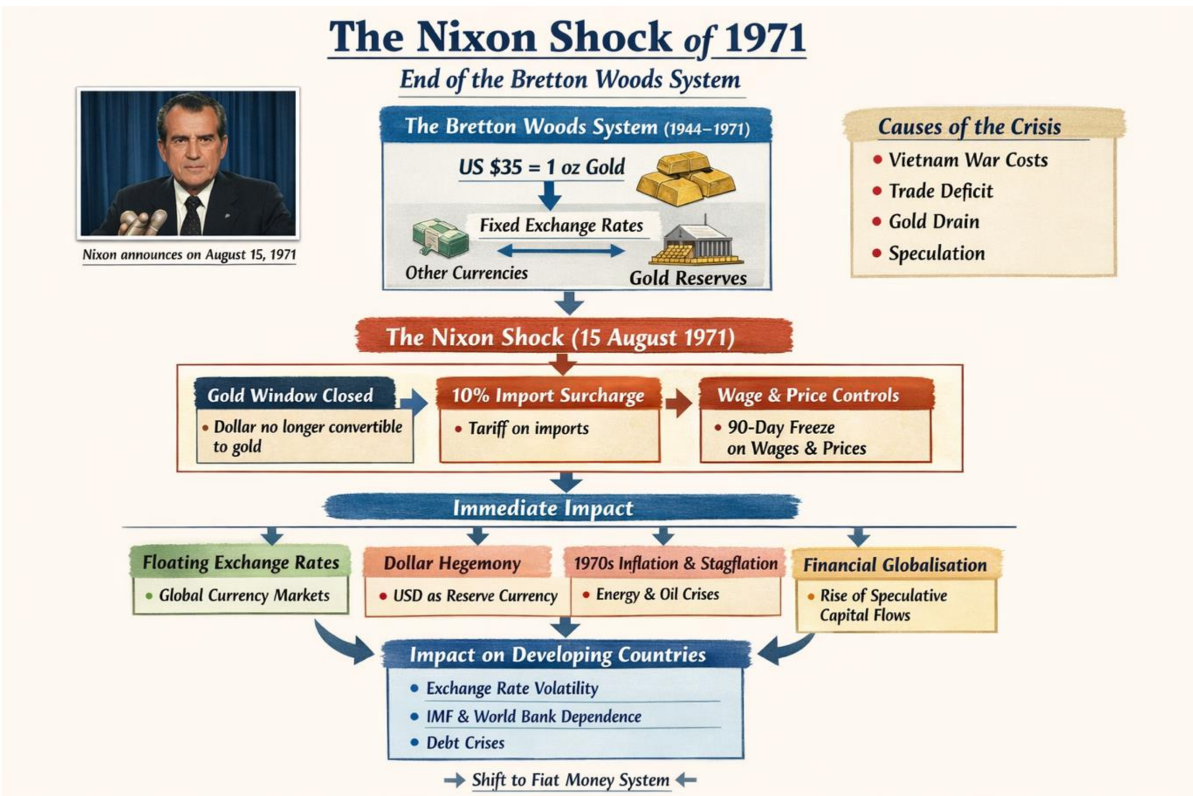
Nixon Shock v/s Bretton Woods

The Bretton Woods system created a fixed exchange rate system backed by gold reserves, combined with strict capital controls and limited monetary independence.

Following the Post-Nixon Shock, the exchange rate was floated. The dollar is now backed by fiat, capital controls have been eased, and monetary policy functions with significant independence.

In Brief

The Nixon Shock of 1971 marked the end of the Bretton Woods system by halting dollar–gold convertibility. This led to the adoption of fiat money and floating exchange rates, fundamentally transforming global capitalism. It sparked financial globalization and cemented the dollar's dominance in the absence of gold backing.



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